

Internal Revenue Service
memorandum

CC:TL-N-3274-90

Br3:BGately

date:

MAR 5 1990

to:

District Counsel, Sacramento W:SAC

from:

Chief, Branch 3, Tax Litigation Division CC:TL:Br3

subject:

This is in response to your request for Tax Litigation Advice of February 2, 1990, which confirmed an informal request for advice of January 30, 1990.

FACTS

Taxpayers' statutory notice of deficiency dated [REDACTED], disallowed deductions for alimony, business expenses and contributions, as well as a dependency exemption for tax year [REDACTED]. Taxpayers timely petitioned the Tax Court and the petition was answered. The case is set for trial during the calendar scheduled for [REDACTED].

After the case was answered but apparently before the case was calendared, the Appeals officer informed District Counsel that C.I.D. wanted to investigate taxpayer for years including the already petitioned [REDACTED] year. A criminal investigation was begun, and summonses were issued to taxpayer's financial institutions on or about [REDACTED]. The Special Agent expects to refer the case to District Counsel on or about [REDACTED], a date scarcely two weeks in advance of trial. The issues in this potential criminal case include the same deductions which the statutory notice for [REDACTED] put in issue. The District Counsel's attorney and the C.I.D. Special Agent are concerned that proceeding with the civil case at this time could hamper the later successful prosecution of the criminal case.

ISSUE

Should a motion to stay the civil proceedings, or an amended answer which alleges fraud, be filed in the Tax Court?

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DISCUSSION

In our view, it is premature to file an amended answer to allege fraud. The suspicion of fraud has not fully crystallized into a referral to the Department of Justice, and the evidence from which affirmative allegations of fraud would be drawn is not yet fully developed.

We share your concerns about the possible impact on the criminal case the present case could have. We believe the best course to follow would be to file a motion to stay the civil proceedings. We recognize that the Court disapproves of these motions. However, in this situation we think a stay is preferable to endangerment of the criminal case. We think the motion to stay could be either a joint motion or respondent's alone. If the motion is joint, petitioner's grounds would be that proceeding with the civil case might tend to infringe on his 5th Amendment rights. If the motion is by the Service alone, it is proper to state the fact of the criminal investigation, the circumstances under which it arose, and its present status. This information can properly be transmitted to the court, under I.R.C. § 6103(h)(4). You should specify that once the criminal case is resolved, the Service may want to amend its answer to allege fraud. The record should clearly reflect the Court's understanding that an amendment is contemplated if appropriate.

We think filing the motion for a stay best protects the Government's interest since disclosure of the criminal investigation is permissible and the theories, evidence and witnesses for the criminal case need not be identified. We have discussed the case with the Tax Practice and Procedure Counsel, Richard G. Goldman, who concurs with this advice.

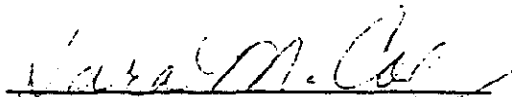
If, as we anticipate, this case does not come to trial prior to resolution of the criminal case, we will not face the issue, discussed in our telephone conversation, posed by Zackim v. Commissioner, 91 T.C. 1001 (1988), rev'd, ___ F.2d ___ (2d Cir. 1989). However, it is our opinion that, pursuant to Zackim, if the Service were to try the [REDACTED] Tax Court case now, we would not be barred by res judicata in a subsequent civil proceeding where fraud is in issue. Obviously, there are hazards to that position in the Tax Court; however, we are anxious to test our position in other circuit courts.

CONCLUSION

A motion for stay of civil proceedings should be filed at your earliest convenience. If you desire further assistance, Blaise Gately of this office is familiar with this matter and can be reached at FTS 566-3335.

MARLENE GROSS

By:


SARA M. COE
Chief, Branch No. 3
Tax Litigation Division

cc: Tax Practice and Procedure Counsel